Weekly Updates Issue # 610

1. Weekly Markets Changes

[April 14, 2017]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
*15,535.48 -131.7 -0.84%	*2,328.95 -26.59 -1.13%	*20,453.25 -202.8 -0.98%	*5,805.15 -72.66 -1.24%	*$0.7503 +0.45¢ +0.60%	*$1,289.00 +32.90 +2.62%	*$53.02 +0.73 +1.40%

** as of Thursday April 13th 2017*

2. Speculators drive housing demand in GTA, but who will help?

[April 12, 2017] The Bank of Canada's governor says there is increasing evidence of speculation in Toronto's hot housing market, where the average price of a detached house has surpassed the $1.5-million mark.

Stephen Poloz says demand is being driven more by speculators or investors, rather than by people buying a home for themselves.

He says the market fundamentals can't explain recent data that showed the average selling price for all properties in the Greater Toronto Area in March jumped 33% from the same month last year.

Poloz says when that happens, the rate of price increase is very unlikely to be sustainable, and he is reminding home owners and buyers that prices can go down as well as up.

Marc Pinsonneault, senior economist at National Bank, says the central bank could help "by ditching its dovish rhetoric and signal[ling] tighter monetary policy ahead to reflect improving economic data but also mounting risks to financial stability." The comment was made in an economics note on housing prices.

He further notes that the proportion of double-digit price inflation across the country is similar to that observed in the U.S. in 2005 at the peak of its housing market.

As home prices and carrying costs climb, Canadians admit to feeling the pressure.

For example, an RBC home ownership poll reveals fewer Canadians believe they are well positioned to weather a downturn in the market (65% versus 73% in 2016) or a potential increase in interest rates (57% versus 63% in 2016). Another one-third of Canadians (36%) would be concerned if their mortgage payments went up by 10% or more.

Cooling commitment comes from Ontario

Ontario Premier Kathleen Wynne has said her government is very close to bringing forward a package of measures to address housing affordability.

On Wednesday, Wynne met with mayors from the Greater Toronto and Hamilton Area today to discuss issues around housing.

While there is no one measure that will change market dynamics, Wynne said she wants the government's initiatives to "calm" the process.

"My hope would be that we can make the process of finding a place to live a bit more rational, a bit more predictable, a bit less frantic for people," Wynne said Wednesday.

Ontario Finance Minister Charles Sousa has indicated a housing package will be in his spring budget, expected in the next couple of weeks. He has floated a number of possible measures, including implementing a tax on foreign buyers, speculators or vacant homes.

He said Wednesday that while market forces will do what is necessary to keep up with demand, he is looking at ways to speed up more supply becoming available.

"People are frustrated," Sousa said. "Families are pissed that they can't win bidding wars. And, in times past, young families will get into the market with those entry market homes. They're hard to come by. So we're going to figure out a way to help do that, too."

Wynne says she wants to see large home price increases come down, but she isn't quantifying to what degree she hopes her plan will cool the market.

3. BoC holds benchmark rate, cites weakness

[April 12, 2017] The BoC is leaving its trend-setting interest rate unchanged because, despite a recent run of stronger-than-expected data, it believes the economy has yet to show it can stick to the higher growth trajectory.

In holding the rate at 0.5%, the central bank says it also considered significant uncertainties still weighing on its outlook — including the unknown yet potentially adverse impacts of the U.S. economic agenda.

The bank says Canadian growth exceeded its expectations, and it now predicts the economy will expand at an annual rate of 2.6% in 2017 — up from its January forecast of 2.1%.

It says the improvement was largely fuelled by unexpectedly robust residential investment, as well as temporary factors such as the resumption of expenditures in the energy sector and the consumer-spending lift from bigger child-benefit cheques.

However, the bank also says export growth has been uneven, and there have been continued signs of weakness in business investment and employment indicators of hours worked and wages.

Avery Shenfeld, managing director and chief economist at CIBC Capital Markets, says in an economics note that greater capital spending and some momentum in exports are needed before a more hawkish tone can be expected.

"It will also be easier for the Bank to start talking about rate hikes after a further hike or two from the Fed, which would prevent rate hikes in Canada from lifting the [Canadian dollar] materially," he says.

The bank now predicts economic growth will slow to 1.9% in 2018.

4. Why the BoC sees just 1.8% growth in 2019

[April 12, 2017] The BoC has revised down its growth forecasts, predicting 2017's growth of 2.6% will slow in the ensuing years, reaching 1.8% in 2019.

While 2017 is performing stronger than expected, the bank held its benchmark rate at 0.5% while revising down 2018 growth to 1.9%, from the previous 2.1%.

"It's largely demographics driving that," says Brian DePratto, senior economist for TD, who sees it as a reasonable estimate. "The demographics are going to be weighing on the labour side of things. We just aren't really seeing a whole lot in terms of investment or other measures to drive the productivity side of things."

Lower potential

The BoC, in its monetary policy report on Wednesday, also lowered its outlook for the economy's potential output, citing an expected decline in the working age population, lower employment and hours worked, and slow productivity growth.

That means the economy is expected to reach its full potential—albeit at a slightly lower marker—sooner. "With this combination of a higher profile for economic activity and a lower profile for potential, the output gap is projected to close in the first half of 2018, a bit sooner than the Bank anticipated in January," the BoC says.

The bank's range for potential output growth now has a midpoint of 1.4% for 2018 (down from 1.5%) and 1.5% for 2019 (down from 1.6%).

The number of retirees, who spend less, is growing, while households overall are deleveraging, says Darcy Briggs, vice-president and fixed-income portfolio manager with Franklin Bissett Investment Management in Calgary.

For clients who ask about a lower-growth scenario, Briggs tells them there are always cycles affecting the markets.

"Like every other cycle, it cycles. This is the bottom part. There's opportunities that can be made in a lower-growth environment," he says, pointing to opportunities linked to equity market gains, low interest rates and changing corporate bond spreads. "You just need to know what to look for."

'Decidedly neutral'

The BoC is "decidedly neutral," BoC Governor Stephen Poloz said in Ottawa, noting there was no option for a cut in the latest decision.

"Given the data that we've seen in the last few months, I can say quite clearly, 'No, a rate cut was not on the table at this time,'" Poloz said, after suggesting the possibility of a rate cut in January. Economists expect the bank to remain on hold through the year.

The BoC expects "a more moderate pace" for economic growth, with activity pulled along by foreign demand, federal fiscal stimulus and monetary policy. While Q1 2017 GDP growth is forecasted to be higher than previously thought, at an annualized pace of 3.8%, the gain is driven largely by strong household spending, higher oil prices and increased government expenditures. The BoC sees annualized GDP growth of 2.5% for Q2 2017.

It says final domestic demand has been weaker than projected as business investment declined and there were delays in government infrastructure spending. Business investment is "well below" expectations as Canadian firms are wary of increased trade protectionism, reduced competitiveness in corporate taxation and other regulatory changes in the United States, the BoC says.

"A notable increase in global protectionism remains the most important source of uncertainty facing the Canadian economy," the report says.

Housing prices can go down, too

Household spending will moderate, the BoC projects, even as housing market activity remains strong in regions like Toronto. The fundamentals don't justify Toronto housing prices jumping by over 30% in the past year, Poloz notes.

"It's that gap, between what fundamentals could manage to explain, and what is actually happening, that suggests there's a growing role for speculation in that [market]. In other words, demand is being driven more by speculative demand," Poloz says. "I think it's timely to remind folks that prices of houses can do down, as well as up."

The federal government's housing policy changes will dampen activity, the BoC forecasts, amid expectations for the market to slow given high levels of household debt and higher longer-term borrowing costs.

5. Oil recovery fragile despite rising commodities index

[April 12, 2017] Scotiabank reports its commodity price index gained 2.2% month-over-month in February, as industrial commodities continue to benefit from healthy demand on the back of a stronger global economic outlook.

The oil recovery remains on track but fragile, says Scotiabank in its commodity price index report.

"Bearish sentiment is likely to weigh on prices until our more bullish fundamental outlook is confirmed by U.S. inventory draws over the coming months," says the report.

The bank has downgraded its WTI price forecast to $53 per barrel in 2017, from $58 previously. For 2018, the price has been downgraded to $56 per barrel, down from $61 previously.

The bank says the downgrade is the result of a stronger U.S. shale outlook, Brazilian output gains temporarily supporting non-OPEC supply outside the U.S., and high U.S. inventories, which have taken longer than anticipated to draw.

Further, the bank expects OPEC to extend its production cap through year-end, because of the combination of high OECD inventories, weak upstream investment outside the U.S. and recent oil price weakness.

Other report highlights:

- Copper forecasts have been upgraded to $2.50 per pound in 2017 and $2.65 per pound in 2018, as a combination of production loss, continued supply uncertainty and potential for stronger Chinese demand are all near-term bullish for prices.
- Aluminum prices are forecast to average $0.85 per pound in 2017 and 2018, as Chinese environmental policies could remove substantial amounts of supply from the market, flipping balances to a moderate deficit in 2017.
- Zinc continues to show the strongest fundamentals, with prices forecast to average $1.35 per pound in 2017 and $1.55 per pound in 2018.

- Nickel supply received potential shock as Philippines President Duterte raised the possibility of banning all domestic mining activity. Prices are now forecast to average $5.00 per pound in 2017 and $5.50 per pound in 2018.
- Gold prices are likely to average $1,200 per ounce in 2017 and $1,250 per ounce in 2018, given a mix of mildly bearish interest rate fundamentals and a balanced risk outlook.

6. Canada one of four advanced economies vulnerable to housing

[April 11, 2017] Moody's Investors Service has released a report that identifies Canada as one of four triple-A-rated countries that are exposed to a potential housing market correction.

New Zealand, Sweden and Australia are the other three countries that have seen the largest increases in home prices and household debt among advanced economies over the last three years, says Moody's.

For Canada and New Zealand, specifically, Moody's says a housing downturn could involve material spillovers to the broader economy. Residential construction accounts for approximately 7.5% of GDP in both countries.

However, Moody's says that unless reversals in house prices are accompanied by other long-lasting negative shocks, they would not fundamentally undermine the sovereigns' credit profiles.

On the upside, the debt-rating agency says all four named countries have strong banking systems with high capitalization levels, conservative business models and strong liquidity. The housing sector has mainly been identified as a risk for the Canadian economy given housing prices have marched higher, fuelled by low interest rates.

Silver lining

In its release, Moody's suggests the situation in Canada–and in the other three countries–shouldn't be compared to the situations in Spain, Ireland and the U.S. in the period leading up to their mid-2000 housing peaks.

Viewed in that context, the pace of the increase in household debt relative to disposable income has been noticeably slower in Canada, as well as in New Zealand, Sweden and Australia. However, the starting levels of household debt relative to income in Canada and the other countries is higher than the starting levels were for the U.S. and Spain.

Moody's notes Australia faces the greatest risk of households needing to deleverage abruptly in an economic or housing downturn, whereas Canada and New Zealand have large, liquid financial assets that would provide some financial cushion to economic shock in the same situation.

Moody's adds New Zealand and Sweden are particularly vulnerable to potential reversals in population booms; "in the event of a negative economic shock, the recent acceleration in immigration could reverse, acting as a further drag on housing demand and economic activity," it says in its release.

For its part, Canada has grown reliant on residential construction, as has New Zealand.

7. Household spending continues to drive growth

[April 10, 2017] As much as the Bank of Canada would like to see a rotation away from household spending and toward manufacturing and exports, the former continues to be the cornerstone of Canada's economic growth.

"Even with the pullback in exports in February that returned the country's trade balance to a slight trade deficit (following three months in surplus), Canada's economy is tracking growth of 3.4% (annualized) in the first quarter," notes James Marple, senior economist at TD Bank, in an economics report.

Benoit P. Durocher, senior economist at Desjardins, says in an economics report that, in January 2017 alone, the value of retail sales surged 2.2% — one of the sharpest monthly increases since retail sales started to be tracked in 1991.

He reviewed data to ascertain whether that consumption indicates a temporary jump or the start of a robust trend.

Pro side

On the positive side are recent gains in full-time jobs and a sharp fall in unemployment.

Since August 2016, almost 275,000 new jobs have been created, representing an average monthly increase of more than 34,000 jobs — a level not seen since spring 2007, he says. And the unemployment rate fell to 6.7% in March 2017 from 7.2% in January 2016.

Accordingly, disposable income has accelerated since mid-2016, which helped increase consumption. And a reduced tax burden, courtesy of the 2016 federal budget, also contributes.

"Households clearly used some of this additional income [from a reduced tax burden] to grow their net savings, which pushed the savings rate to 5.8% in the fourth quarter of 2016, compared to a rate of only 4.7% in the first quarter of that year," says Durocher. The data show that some of that income was also used to increase consumer spending.

Canadians' confidence has also increased in the last few months, with the household confidence index rising to 111.7 in March, a level that exceeds the historical average. That bodes well for spending, especially for durable goods, says Durocher.

Con side

Households' reduced tax burden will gradually fade over the next few months, says Durocher, which could affect spending by year-end. Further, debt levels are relatively high, but, with low rates, households aren't yet feeling the pinch. That could change with rising rates.

"Based on our estimates," says Durocher, "the average interest on household debt would only have to go up about 65 basis points to put the debt service ratio above its historical peak," cutting into future consumption.

Also, wage growth is weak, with average hourly wages flat since spring 2016. "If this weak wage growth continues, it could partially erode the benefits of surging job creation on consumption spending growth," he says.

Weak wage growth is consistent with the lagging influences of the commodity shock on incomes, says Derek Holt, vice-president and head of capital markets economics at Scotiabank, in an economics update on wage growth.

"Canada is probably not even two-thirds of the way through the full aftermath of the commodity shock on incomes," he says, and also notes weak wages are a reason for the Bank of Canada to retain its dovish outlook.

But, based on the overall data, Durocher expects household consumption spending to be positive in the next few quarters, especially as residential investment continues to rise. But additional restrictive measures to the housing market, especially in the Greater Toronto Area, could rein in residential investment's contribution to economic growth in the second half of 2017, which would by extension decrease households' contribution to GDP.

8. Housing starts reach highest level in nearly a decade

[April 10, 2017] The annual pace of housing starts increased more than expected in March and hit its highest level since September 2007.

The Canada Mortgage and Housing Corp. says the seasonally adjusted annual rate of housing starts for March came in at 253,720 units, up from 214,253 in February.

Economists had expected a reading of 215,000 for last month, according to Thomson Reuters.

The overall increase came as the annual pace of urban starts increased by 20.2% to 235,674 units, boosted by an increase in multi-unit starts.

Multi-unit urban starts increased by 30.2% to 160,989, while single-detached urban starts increased by 3.1% to 74,685 units.
“We had noted that a decent build up of unused permits suggested strong upcoming readings,” says Nick Exarhos, director at CIBC World Markets, in an industry note, “and March saw the benefits.”
“The strength was particularly pronounced in Toronto and Vancouver,” notes Michael Dolega, senior economist at TD Bank, in an industry note. New supply is particularly welcome in Toronto, where a lack of inventory has helped fuel rising home prices.
“The completion of these units should help take some steam out of Toronto’s home price growth,” says Dolega, “although this won’t happen overnight and is likely a story for next year and beyond.”
Exarhos says a strong building start in 2017 sets the stage for continued momentum in residential investment, which CIBC hadn’t originally counted on when making its annual forecast.
Dolega, however, says housing starts are likely to slow as the effects of a warm winter manifest in a slower building pace during spring and summer.
Still, the strong showing in housing starts is yet another strong economic indicator ahead of Wednesday’s monetary policy report from the Bank of Canada. “But don’t expect Governor Poloz to change his dovish script — at least not yet,” says Exarhos.

9. Travelling to the U.S.? What to know about preclearance?

[April 11, 2017] Many Canadians know they can clear U.S. customs at Canadian airports — a process known as preclearance. But changes to the rules are likely because of a new bill, Bill C-23, the Preclearance Act, 2016.
The bill expands preclearance operations in Canada, covering all modes of transport for both passengers and cargo. A key feature is the broader powers for United States Customs and Border Protection (U.S. CBP) officers operating at Canadian airports and other departure points. The U.S. version of the bill was enacted in December 2016, allowing Canada Border Services Agency (CBSA) officers stationed at U.S. airports to hold reciprocal rights to screen travellers headed for Canada.
Supporters of expanded preclearance rules highlight potentially greater efficiency and faster travel procedures. But detractors highlight the greater potential for rights infringements and privacy breaches.

What could change

Bill C-23 was submitted for second reading on March 6, 2017, and is now with the Standing Committee on Public Safety and National Security. Here's a summary of what the bill contains:

Preclearance procedure	**Existing law**	**Proposed rule**
Searches	Preclearance officers may "frisk search" a person only if they suspect the person is carrying anything that would endanger human life or safety or that provides evidence of false or deceptive statements. Based on the above, preclearance officers may also detain people for strip searches, but only CBSA officers can perform them.	Preclearance officers may "frisk search" a traveller bound for the U.S. if they reasonably suspect the traveller has concealed goods. Preclearance officers may also conduct strip searches based on the above and if "the search is necessary for the purpose of conducting preclearance."
Withdrawing from a	Every traveller has	A traveller who withdraws from preclearance must

preclearance area	the right, at any stage of the process, to leave a preclearance area without departing for the U.S., unless the traveller is suspected of committing an offence. Refusal to answer questions from a preclearance officer does not constitute an offence.	(a) answer truthfully any question asked by a preclearance officer for the purpose of identification or determination for withdrawal; and (b) comply with other related directions from the preclearance officer.
Officers carrying guns	Preclearance officers aren't allowed to carry firearms in Canada.	Preclearance officers will be permitted to possess, transfer, import and export a firearm, prohibited weapon or restricted weapon (e.g., a handgun).
Biometric information	N/A	Preclearance officers may collect biometric information, other than from the traveller's bodily substances. However, officers can't collect this information unless they're told within the preclearance area that the traveller is withdrawing.

How travellers could be impacted

The federal government has stated that expanded powers for U.S. CBP officers won't undermine Canadians' rights and freedoms. A parliamentary blog post by Ralph Goodale, the minister of public safety and emergency preparedness, who sponsored the bill, says: “The powers that U.S. border officers exercise under Canadian law are governed by the Canadian Bill of Rights, the Canadian Human Rights Act and the Canadian Charter of Rights and Freedoms.”

Preclearance locations in Canada

- Existing: U.S. preclearance operations began at Toronto Pearson International Airport in 1952. Preclearance is currently available at seven other airports: Vancouver, Calgary, Edmonton, Winnipeg, Toronto, Ottawa, Montreal and Halifax.
- Proposed: Preclearance is expected to be introduced at Billy Bishop Toronto City Airport, Québec City Jean Lesage International Airport and Montreal Central Station.

But cross-border immigration lawyer Henry Chang, a partner at Blaney McMurtry in Toronto, is skeptical, because it’s unclear how Canadian rights would be protected. “As you start looking more closely, it’s clear there isn’t a lot of opportunity to enforce any violation[s],” he says.

Excessive questioning by preclearance officers

The bill gives preclearance officers broad power to question a traveller bound for the U.S. — with no requirement that questions be reasonable or relevant. Therefore, travellers could be asked about their religion or drug-taking history, says Chang.

Withdrawal obligations

Currently, Canadians can opt out at any time during the process. If the new law takes effect, however, Canadian travellers will have to truthfully explain why they’re withdrawing applications for admission. The bill also authorizes officers to exercise reasonable force, which may include detaining travellers until they’ve answered questions to their satisfaction.

“Refusing to answer questions or walking away could result in a traveller being found to be non-compliant […] or obstructing a preclearance officer,” says Barbara Jo Caruso, vice-chair of the Canadian Bar Association’s immigration section, in an email.

And the bill could make such resistance or obstruction a criminal offence.

Removal of the unqualified right to withdraw could hurt all travellers, including business travellers, says Caruso. Currently, when a business traveller withdraws a request to enter the U.S. so that, for example, she can seek legal counsel on whether to get a work permit, the traveller avoids being denied entry, which could adversely impact any future application. The traveller can then return and make a fresh request, says Caruso. Under the new rules, that option wouldn’t be available.

Potential loss of electronic devices and NEXUS cards

Bill C-23 doesn't address the issue of U.S. CBP officers examining travellers' electronic devices or accessing passwords. And Canada's existing law remains murky in this regard.

Nonetheless, CBSA policy states that personal device exams should be conducted only if there are grounds or indications that "evidence of contraventions may be found on the digital device or media," says the privacy commissioner's website.

Caruso notes that once the new preclearance rules take effect, U.S. CBP officers won't be required to return goods seized and detained in the preclearance area, even if no contravention occurred. U.S. CBP officers could destroy seized laptops or personal devices, and there won't be a way to request the items be returned, she says. As such, business travellers should avoid travelling with confidential client information.

Caruso also notes the bill is silent on the seizure or cancellation of NEXUS cards, so there's no provision to review a decision to revoke NEXUS.

Be prepared

When advising business travellers specifically, Caruso recommends preparation. "Know where you are going, who you will be meeting with, for how long and for what purpose. Carry a letter from your employer confirming these details so you can present the letter if you are challenged about your verbal declaration."

Caruso suggests seeking legal advice in advance if travellers are unsure about admissibility or whether they require work permits. "Understand that more data with respect to travel history is being maintained and shared between governments, so inaccuracy in answers could lead to concerns over credibility and ultimately result in denial of entry. Also, […] a misrepresentation can result in a five-year ban to enter either country."

Have a nice and fruitful week!